

PACIFIC COMMUNITY

FIFTH PACIFIC REGIONAL ENERGY AND TRANSPORT MINISTERS' MEETING

(Port Vila, Vanuatu, 8-12 May 2023)

AGENDA ITEM E14B - STOCK-TAKE OF FOSSIL FUEL SUBSIDIES IN THE PACIFIC

[Jointly submitted by the Pacific Region Infrastructure Facility (PRIF) and the Pacific Community (SPC)]

Purpose

1. The purpose of this paper is to highlight the results of a recent study on Fossil Fuel subsidies among the thirteen Pacific Island Countries (PICs) which are PRIF members¹, and recommend next steps for data collection, reporting and monitoring.

Background

2. Fossil Fuels are a significant national expense in the Pacific Islands region. Prior to COVID-19, fuel imports were between 4% to 13% of GDP for PICs. Many countries have policies subsidizing fossil fuels, however these policies can be expensive, not very effective at helping the poor, and delay the transition to renewables. Other than a SPC study for Kiribati in 2017, not much is known about fuel subsidies in the Pacific.
3. The Third Pacific Regional Energy and Transport Ministers' Meeting (3rd PRETMM) in 2017 outcomes included: encouraging reviews of fossil fuel subsidies, including tax and excise policies; agreement to provide assistance and national data for SPC to carry out research and technical assistance regarding fossil fuel subsidies; and directing SPC to conduct further investigations and assess the value of a regional commitment by the Pacific to declare itself as a region free of fossil fuel subsidies. At the Fourth Pacific Regional Energy and Transport Ministers' Meeting (4th PRETMM) in 2019, it was further agreed to: strengthen and consolidate support to existing efforts including assessing the feasibility of phasing out fossil fuel subsidies; and support UN ESCAP's NEXSTEP model, used to demonstrate how carbon tax and fossil fuel subsidies can influence the least cost options that are available to a country, based on its energy policies.

Current status

4. Following these directions from Ministers, the stock-take of fossil fuel subsidies study has been undertaken by the PRIF in collaboration with the Pacific Community. PRIF is a multi-partner² coordination and technical assistance facility for improved infrastructure in the Pacific.
5. Through this study, a stock-take, quantification, and evaluation of the effectiveness of fossil fuel subsidies has been undertaken among PRIF's member countries. It assists governments to report their efforts on SDG indicator 12.c.1 which refers to the "Amount of fossil fuel subsidies per unit of GDP (production and consumption) and as a proportion of total national expenditure on fossil fuels". The information gathered through this study can help governments and development partners to understand and evaluate the effectiveness of fossil fuel subsidies. Additionally, the

¹ PRIF's Pacific member countries are Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Nauru, Niue, Palau, Republic of the Marshall Islands, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu. Papua New Guinea is an associate member.

² Asian Development Bank, Australian Department of Foreign Affairs and Trade, New Zealand Ministry for Foreign Affairs and Trade, European Investment Bank, European Union, Japan International Cooperation Agency, World Bank Group, US Department of State.

study results are relevant to discussions about fiscal sustainability, affordability, regulation and decarbonization opportunities in the transport and energy sectors.

6. Definitions and examples of the different types of fossil fuel subsidies are provided in **Attachment A** below.
7. Recent events, including the COVID-19 pandemic, and the Russian invasion of Ukraine and the recent 2nd Ministerial Dialogue on Pathways for the Global Just Transition Away from Fossil Fuels have highlighted the continuing economic and climate vulnerability of PICs to fossil fuel and its prices. Impacts of higher fuel prices already being observed in 2022 include: increasing inflation, deteriorating terms of trade, and impacts on government budgets from higher costs for their fuel own consumption, tax relief and support measures for households and businesses. As a result, the study has also identified a number of temporary support measures adopted in PRIF member countries.

Issues and Highlights

8. Data collection for the study resulted in adequate data for eight of the thirteen countries included in the study, with partial data being collected for the remaining six. Data collection and stakeholder engagement for the study was primarily via national energy office contacts, facilitated by SPC. In most countries, subsequent interviews were held with customs agencies and economic regulators, with data supplied from intentionally standardized customs reporting (via the ASYCUDA system) and/or regulatory reporting. A key gap in data collection was disaggregated budget and tariff data, which was generally not readily available in time for the study.
9. A key step in estimating subsidies is building up the different components that make up retail prices. Several countries monitor or regulate fuel prices, however regular fuel price monitoring is a key gap in many countries. Retail prices in most countries were found to be broadly consistent with costs. A key variance in retail fuel prices across countries is differences in the taxes applied. Fuel taxes are an important revenue item for most governments, but exemptions for certain uses (such as electricity generation or fishing) are a key source of subsidies through revenue forgone.
10. The study identified 68 potential subsidies, of which 33 were quantified. The most common subsidies quantified were revenue forgone from exemptions provided in tax and excise policy, and undertaxed externalities³. Many of these measures are not obviously intended to be subsidies (e.g. VAT exemptions on inputs), but consistent with international best practice, they have been identified in the study to promote understanding and evaluation of fossil fuel policy. Direct transfers and support through electricity tariffs are also common but the fossil fuel component of these subsidies is challenging to consistently identify and quantify.
11. The 33 subsidies quantified had a total value of USD 42 million (excl. externalities) or USD 436 million (incl. externalities) in 2019 across the thirteen countries in the study (including countries for which only partial data was available). A summary of the subsidy estimates for each PIC are included in **Attachment B**. On a share of GDP basis, this is equivalent to 0.4% of GDP (excl. externalities) or 4% of GDP (incl. externalities) in 2019. This is likely to be an underestimate of the value of subsidies across the region, given the extent of unquantified direct support to utilities and through electricity tariffs. Even on these partial estimates, subsidies may be

³ A well established principle in evaluating fossil fuel subsidies is to consider not just the market price of fuel, but also socially efficient price, which includes the environmental costs and broader externalities of fuel use. An externality is a cost imposed on others not directly involved in a transaction. For this study, estimates of the value of externalities of fuel use developed by the IMF in 2021 for 9 PICs have been used. These estimates include values for carbon emissions (global), local air pollution, congestion and accidents.

significant, particularly for smaller countries such as Kiribati, Republic of the Marshall Islands, Nauru and Tuvalu, for which subsidies were in the range of 2.0 – 3.4% of GDP (excl. externalities).

12. The value of subsidies identified in the study is based on data for 2019, which was adopted as being most representative of a typical year, prior to COVID-19 and the Russian invasion of Ukraine in 2022. Since 2019, many countries have introduced temporary support for consumers, industry and utilities which are dependent on fossil fuels. As such, in many countries the current level of support for fossil fuel consumption may be much higher than quantified in this study. Several examples have been identified including: temporary import duty or VAT reductions (e.g. Fiji, Solomon Islands), introduction or expansion of price controls on fuel and electricity, pressure on State Owned Enterprises (SOEs) to limit pass-through of fuel costs, and supplementary grants to SOEs.
13. Subsidy impact was considered using key macroeconomic indicators (e.g. balance of payments) and affordability indicators (e.g. fiscal and household expenditure on transport and electricity) where available. Subsidy effectiveness was considered with regard to impacts on prices and demand. The key findings on impact and effectiveness are that even on partial estimates, subsidies are a material component of government and national expenditure and can be a significant cost for smaller countries. The quantified subsidies have an identifiable impact on prices and demand. Distributional impacts are less obvious – poorer households consume less, and receive less of the absolute benefit, but they are more vulnerable as fuel makes up a larger proportion of budgets.
14. In terms of assisting governments to report their efforts on SDG indicator 12.c.1 “Amount of fossil fuel subsidies per unit of GDP (production and consumption)”, the study found that data is available in most countries. However data coverage is generally incomplete for some key categories of subsidies, such as those provided through electricity subsidies and direct budget support. More work is needed to ensure that disaggregated budget and tariff data will be readily available for SDG reporting on this indicator, in time for the national reporting required for Phase 3 of SDG reporting on this indicator by 2025.

Recommendations

15. The meeting is invited to:
 - a. **note** the key findings of the study and its relevance to the Just Transition to a Fossil Free Pacific and **encourage** all PICTs to review the effectiveness of their fossil fuel subsidies.
 - b. **encourage** all PICTs to strengthen national efforts in reporting and monitoring of fossil fuel prices and subsidies.
 - c. **encourage** all PICTs to prepare for reporting of SDG indicator 12.c.1 by 2025, noting key information gaps identified in this study.

Attachment A: Subsidy definitions

Subsidy Category	Example
Direct transfer of government funds	<ul style="list-style-type: none"> • Direct spending, budget and off-budget transfers • Government ownership of energy-related enterprises if on terms and conditions more favorable for business than in case of private ownership
Induced transfers (price support)	<ul style="list-style-type: none"> • Price support, including through market regulation
Tax expenditure, other revenue forgone and under-pricing of goods and services	<ul style="list-style-type: none"> • Tax breaks and other government revenue foregone • Under-pricing of government-owned energy resources • Under-pricing of non-energy, government-owned natural resources or land • Under-pricing of government-owned infrastructure • Under-pricing of other government-provided goods or services • Below-market lending to energy-related enterprises, including loans to energy exporters, and debt restructuring and cancellations
Transfer of risk to government	<ul style="list-style-type: none"> • Credit support through risk transfer mechanisms like loan guarantees • Debt restructuring and cancellations • Insurance and indemnification • Assumption of risks related to occupational health and accidents • Assumption of responsibility for remediating environmental damage

Source: adapted from UNEP (2019) *Measuring Fossil Fuel Subsidies in the Context of the Sustainable Development Goals*

Attachment B: Subsidy estimates (USD 2019 \$ million)

Country	Direct Transfer	Revenue Forgone	Induced Transfer	Externalities	Total (excl. externalities)	Total (incl. externalities)	% GDP (excl. externalities)	% GDP (incl. externalities)
Cook Islands	-	1.40	-	4.99	1.40	6.39	0.4%	1.8%
Federated States of Micronesia	-	-	-	33.17	-	33.17	—	8.0%
Fiji	-	3.27	-	151.55	3.27	154.82	0.1%	2.8%
Kiribati	-	0.36	5.36	6.59	5.72	12.31	2.9%	6.2%
Republic of the Marshall Islands	0.60	4.05	-	7.74	4.65	12.39	2.0%	5.3%
Nauru	-	3.74	-	11.03	3.74	14.76	3.2%	12.8%
Niue	-	-	-	1.09	-	1.09	—	3.5%
Palau	-	0.27	-	30.57	0.27	30.84	0.1%	11.2%
Samoa	-	8.76	-	20.45	8.76	29.22	1.0%	3.4%
Solomon Islands	-	2.14	-	82.98	2.14	85.13	0.1%	5.4%
Tonga	-	5.85	-	41.51	5.85	47.36	1.1%	9.3%
Tuvalu	1.74	0.12	-	2.13	1.86	3.99	3.4%	7.4%
Vanuatu	-	4.66	-	0.30	4.66	4.96	0.5%	0.5%
Total	2.34	34.63	5.36	394.11	42.32	436.43	0.4%	4.0%

Source: consultants estimates